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## CURRENCY REFORM

The inelasticity of our forms of money is by this time a trite subject; but the conditions of the money market, which recently led to a general resort to clearing-house certificates throughout the country, has brought new interest in measures of reform. Obviously, a strong impetus has been given to the discussion of an emergency issue by the national banks, and there is an evident determination to secure currency legislation from the coming session of Congress.

As everyone knows, in amount, our greenbacks (United States notes), and our silver circulation are fixed at a rigid limit, which can be neither increased nor diminished. The national bank notes are, also, inelastic, for all practical purposes, for elasticity implies the possibility of expansion in case of a real need, and of automatic contraction when the need has passed. The banks can take out new circulation only by securing and depositing United States bonds with the comptroller. Inasmuch as these notes are printed from separate plates for each bank, the sending in of bonds, the printing of the notes in Washington, their shipment to the bank, and the signing of the notes by the respective bank officials, cause more or less delay before the notes are ready to be issued. This delay is such that, unless foreseen, bank notes can seldom be obtained soon enough to meet a sudden emergency. On the other hand, their contraction is much more delayed than their expansion. The very uniformity and safety of national bank notes constitute the reason why they would not be sent in for redemption by anyone else than the issuing bank. The circulation being out in all parts of the country, any one bank can but seldom get hold of its own notes. Just so far as they are presented to the one Redemption Agency in Washington will the bank have its own notes returned. If a bank wishes to withdraw its circulation, it can begin the process by depositing lawful money with the treasury to the amount of the notes to be withdrawn, and thereupon it can take away the bonds so far kept for their ultimate redemption. This "doomed circulation" is still out in the hands of the public, and cannot be contracted except by the slow method of waiting until the notes are sent in by other banks, or until they become worn or mutilated enough to be sent in

for redemption to secure fresh notes. That is, the notes themselves are not withdrawn in any reasonable time; and general contraction is accomplished only in the sense that an equivalent sum in lawful money—not bank notes—is hidden away in the treasury. Moreover, reduction of national bank notes is impeded by the law of July 12, 1882, which forbids more than \$3,000,000 to be withdrawn in any one month. Consequently, when a large bank wishes to issue notes temporarily, in such an emergency as the present, it knows that it is practically impossible to withdraw them after the emergency has passed. Therefore, of all our varied forms of lawful money only gold is truly elastic. If we have too much we can send it to the arts, or ship it abroad; if we have too little, we can import from any market in the world on which we have credits. Finally, as has been recently displayed in an impressive manner, the only “currency” which is really elastic in every sense, and the only one to be resorted to when every other medium of exchange is unavailable, is the deposit currency (checks drawn on deposits). While clearing-house certificates are in use between banks, checks have become the universal and efficient currency with which merchants meet their engagements both with individuals and the banks. If a borrower can get a loan he can meet his maturing obligations effectively by the use of checks. In a crisis, however, the one important thing is getting the loan, and getting it in the form of a means of payment which his creditor will accept.

Yet, borrowers may in some cases require notes which can be used in paying wages, and in meeting the needs of retail trade, expenses of travel, and the like. In a crisis like the present, this demand for money could be adequately met by the issue of bank notes; and the amount of lawful money in the pockets of the people could be replaced safely by bank notes. When frightened depositors draw and hoard money, it is now taken from lawful money reserves, and reduces the power of the bank to lend by at least four times the sum of the withdrawals. Therefore, if those depositors could be induced to accept bank notes, instead of lawful money (gold and gold certificates, silver and silver certificates, greenbacks, and treasury notes of 1890), there would be at hand a means of quieting the public alarm, and of preventing what is practically a general suspension of cash payments. To this extent the issue of an emergency circulation by the national banks would have a salutary influence. There is here a field for bank notes of unmistakable impor-

tance, which justifies all the arguments in favor of new legislation, such as is proposed by the Fowler Bill, or by the American Bankers' Association.

The public, however, seem to be expecting more than this from coming legislation; in asking for an elastic currency, seasonal elasticity for crop movements and the like is not the only thing in mind. It is hoped that a new currency law will give the means of averting the difficulties of a commercial crisis like the present; but it is well to make clear that such a hope is wholly elusive. There is more than one element in the existing situation which is beyond the influence of legislation, present or future. In the first place, there is general agreement that the high rates of interest during the past year, not only in the United States but in Europe, were due to a relative scarcity of capital. The prodigious development of our resources, and the expansion of opportunities for the use of capital, have accompanied a more or less corresponding growth in Europe. In fact, recent events have emphasized the truth, which need not be enforced for economic students, that interest is primarily paid for capital, not for "money." If our banks had abundant capital today, they would have no difficulty whatever because of any lack of a medium of exchange in passing it over to railways, or to merchants, who wished to borrow. An entry in a deposit account on which a check could be drawn would alone serve the purpose. In truth, there is no "scarcity of money" for carrying on exchanges other than those occasioned by the demands of payrolls, retail trade, and the like. The great need is a loan; and the only real scarcity, so far as it concerns money, is in the kind which can be used in lawful reserves, and which regulates the immediate ability of a bank to lend. Moreover, there is no scarcity of gold in the world with which reserves can be increased; for the burden of recent discussions on gold has been the influence of its vast production in increasing the level of prices. In short, the scarcity of lawful reserves in the banks, or the consequent limitation of loans, is directly traceable to a lack of banking resources with which to buy enough gold to carry the growing burdens of trade, or it is due to investments of the bank's resources in assets of a more or less speculative quality which cannot be realized upon in an emergency. Therefore, to the extent that promotion schemes, or overtrading, form the basis of bank loans we have a case of abnormal credit to deal with. The acceptance of questionable collateral is

wholly a matter of banking judgment, and it has nothing whatever to do with abundance or scarcity of money. Even if reserves were full, a bad loan would still remain a bad loan. It is to be seen, then, that congressional legislation could not be expected to remedy any lack of capital, or to avert the effects of past misjudgment, or of folly, in accepting doubtful collateral.

It is highly important to disabuse the popular mind of the fallacy that the real difficulties of a crisis like the present can be removed by the issue of bank notes. As has been repeatedly said, the crucial need, the one need important above all others, is that of obtaining a loan to meet maturing obligations or of continuing a loan already made. If banks, because collateral shrinks, or loans fall due, begin to call in loans, and refuse continuations, in order to build up their reserves, general liquidation and depression are at hand. The ability to lend is the crux of the whole matter; and other things are secondary to it. How true this is may be seen by the action of the Bank of England in a panic. While the Act of 1844 has not saved the English from serious collapses of credit, its operation has disclosed the real source of difficulty in the ease or difficulty of getting loans at the banking department. This difficulty is not primarily in a lack of money; nor is the increase in the rate of discount, as at present a direct increase in the charge for gold. The high rate of discount affects only loans at the banking department, which is entirely independent of the issue department. When, in the former, new loans are made, the deposits are increased, and the percentage of reserves to deposits is lowered. And it is to be remembered that Bank of England notes are permitted in the reserves. If, in a crisis, a great pressure for loans develops, the bank—above all things—does not refuse to lend, even if its reserves are drawn down. Instead, the directors violate the law forbidding the issue of more than about sixteen and three-fourths millions of pounds on the security of government bonds; take bonds from the assets of the banking department to the issue department; get notes on the security of these bonds; and thereby replenish the lawful reserves of the banking department. This means that all borrowers with satisfactory collateral can get loans. That fact once widely known stops the rush for loans not absolutely imperative; and the alarm subsides.

The lessons from the previous discussion, as well as the experiences of European banks, must be very plain. Nothing can be of any help to us, in the present crisis, which does not aid the banks

in lending to legitimate borrowers. Just in so far as securities can be used to obtain more lawful money—money which can be added to the reserves, and thus increase the power of the banks to relieve needy borrowers—can currency schemes be of any great use in a financial crisis. This truth can be fully appreciated by observing the present purchase of foreign gold by use of credits on Europe based on cotton or grain bills, or sale of our cheap securities. Here is one direct way of securing our lending power, and of holding up our commercial houses which need extension of loans; since changing assets into gold directly touches the power to lend. The extraordinary decline of lawful reserves in the New York banks for the week ending November 9, to \$51,000,000 below the legal limit, coupled with a large increase of loans, shows that the banks were doing the only wise thing—making necessary loans—and yet liberally furnishing actual cash to other parts of the country out of their reserves. The only question is whether the imports of foreign gold will overtake the withdrawals from the reserves.

The only other direct means, under the present law, is to collect greenbacks, silver, and treasury notes of 1890. The last are almost eliminated; and the former two are rigidly fixed in amount. But, we hear on every side of a demand for more bank notes. Would the issue of their own bank notes, their demand liabilities, increase the ability of the banks to lend? Evidently not. These notes could not be used in their reserves; nor should they ever be so allowed. In short, an elastic bank currency could not directly avert the essential difficulties of the present situation—the supposed elasticity in a financial crisis is not, as is usually thought, a matter merely of more “money.”

In this connection, the plan of the American Bankers’ Association, and that of the Fowler Bill should be carefully studied. These plans are practically identical, and contain the following provisions:

1. Any national bank having been actively doing business for one year and having a surplus fund equal to 20 per cent. of its capital shall have authority to issue credit notes as follows, subject to the rules and regulations to be fixed by the comptroller of the currency:

(a) An amount equal to 40 per cent. of its bond-secured circulation, subject to a tax of  $2\frac{1}{2}$  per cent. (3 per cent. in the Fowler Bill) per annum upon the average amount outstanding.

(b) A further amount equal to  $12\frac{1}{2}$  per cent. of its capital, subject to a tax at the rate of 5 per cent. per annum upon the average amount outstanding in excess of the amount first mentioned.

2. The same reserves shall be carried against credit notes as are now required by law to be carried against deposits.

3. A 5-per-cent. guarantee fund for the redemption of the notes of a defaulting bank.

4. Numerous redemption offices in various parts of the country, to secure easy and quick redemption when desired.

5. The repeal or the modification of the Act of July 12, 1882, limiting the withdrawal of notes to \$3,000,000 in any one month.

It will be observed from these provisions (1) that the emergency circulation, in the issue of at least the first 40 per cent., is contingent upon the bank's previous issue of notes secured by government bonds. When we remember that the largest city banks, have, as a rule, made little or no use of their right to issue notes, and that they have done their enormous business, earned their profits, and built up their huge surpluses, solely by the use of the deposit currency, we shall see that were such legislation now in force the great banks of New York and other cities would not have been able in the present crisis to issue any emergency notes to speak of.

Again, it is to be observed (2) that the same reserves of lawful money are to be maintained behind these emergency notes as behind ordinary demand deposits. If this were enacted, and if there were a great pressure for loans from the business public, as at present, a bank would be just as much inhibited from granting a loan in the form of its notes as in the form of its deposits. In the case of any drain on its lawful reserves, it would be checked from lending in either form. The privilege to issue emergency notes would not, under such a law, aid the banks in lending to legitimate borrowers, and therefore in averting the disasters due to weakened confidence, a run on cash reserves, or eventual liquidation. In short, so-called currency evils are not responsible for the present crisis; nor would the legislation now proposed meet the essential needs created in a serious financial stringency. To allow the banks to increase their own evidences of debt will not increase their reserves of lawful money, or their ability to lend.

This examination of the proposed reforms of our currency ought not, however, to be regarded as an argument against their desirability as good legislation. The reasons for wishing an elastic bank currency are good and sufficient in themselves; but they must not be used for supporting emergency notes as a real cure for the evils of such a financial crisis as the present one. In justice, on the other hand, it should be said, that a quick issue of bank notes

during a time of threatened danger would be a great help in warding off assaults on the lawful reserves. Whenever depositors called for "money," and payments were made in the bank's own notes, for a time the public would be satisfied, and the lawful money reserves would be kept intact. Thus, the right to issue emergency notes would be a very useful device in protecting for a time the lawful reserves from depletion; and in a stringency of no great severity, the amount of such notes would prevent the evils of abnormal credit from doing much injury.

It has been observed by Mr. Fowler that an enormous amount of lawful money is now out in the hands of the people, which, if in the reserves of the banks, would increase the power of the banks to lend beyond all question. Obviously, the banks ought—under proper safeguards—to be allowed to issue notes in such denominations, and in such amounts as the public want them. That proposition brings in its train, however, many important considerations, one of which is the treatment of our silver circulation. The Act of 1900 particularly provided means by which the silver circulation should be of such denominations as would secure its being kept out in the hands of the public. Hence, if it be argued—and there is a good ground for the argument—that the silver circulation should be displaced by small bank notes, then we must extend the reform of our currency to include the various forms of silver money. This makes it clear that anything but a monetary *pis aller* must deal with more than our bank-note issue. Indeed, sooner or later, we must face the larger questions in our currency shortcomings due to other than bank issues. Whether this is the psychological hour or not for a real reform remains to be seen.

If we are capable, in this country, of intelligently facing the problem of creating an efficient method of meeting, or mitigating, the inevitable dangers of a financial crisis, we must establish some institution wholly free from politics, or outside influence—as much respected for character and integrity as the supreme court—which shall be able, in a great emergency to use government bonds or selected securities, as a basis for the issue of forms of lawful money which could be added to the reserves of the banks. Nothing else than this will meet the imperative need of loans. Bank notes are not a legal tender between private persons; and could not be made into lawful reserves for the very issuers of the notes. It is doubtful if a great central bank—apart from its political impossi-

bility—would accomplish the desired end. It is conceivable, however, that a commission of a high order, appointment to which would be a great honor, might, under general legislation, be competent to do for the United States what in effect the governor and directors of the Bank of England do for the English money market, when they create additions, under the advice and consent of the government, to the lawful reserves of the banking department.

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